

**HISTORY OF BANK INDONESIA : MONETARY
Period from 1997-1999**



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1. Highlights

Indonesia was hard hit by the monetary economic crisis from July 1997 which severely jolted the national economic and political life. As for the banks, the crisis sparked enormous liquidity problem following the collapse the inter-bank money market (PUAB). As the lender of the last resort, BI had to maintain its banking and payment stability to make sure that the national economy would survive. Indonesia's rupiah exchange rate sharply declined and this sparked



the government to tighten rupiah by introducing exceptionally high interest rate and shifting the funds belonging to the state-owned enterprises/foundations from banks to BI (SBI) as well as the tightening of the Government budget. This policy apparently caused the market interest rates to soar excruciatingly and drain the banking liquidity and sparked acute liquidity problem. People panicked and their trust in the banking sector plummeted. This was followed by massive banking fund withdrawal which triggered another liquidity problem to the entire banking system. Consequently, the payment system would be likely put to a halt and the national economy would be shaken. To immediately address this mayhem, the government invited IMF to help cope with the crisis. On 31 October 1997, the Indonesian approved the 1st Letter of Intent (LoI) which was the IMF program to rehabilitate from the crisis. The government among others declared it would repay the depositors.

Entering 1998, the economic conditions were fast deteriorating. The rupiah exchange rate against US dollar dropped to Rp16,000 as the supply of goods depleted sharply due to decreasing production activities and disturbed distribution channel following the damage of trading centers as a result of the mass riots in May 1998. On 15 January 1998, the government accelerated the economic with the second LoI followed by the third LoI dated 8 April 1998 which addressed stabilization and rehabilitation against rupiah, suspension of 7 banks and put them under IBRA as well as settlement of the private sector's debts to the government as mediator. Further, the fourth Letter of Intent was signed on 25 June 1998 which contained the revisions of economic targets and implementation of Social Safety Net (JPS) to address massive unemployment problem.

Apart from overcoming the monetary crisis, the government also helped settle the offshore loans made by the private sector by among others, setup the Team to Settle Private Offshore Loans (TPULNS). This team managed to reach the deal in Frankfurt on 4 June 1998 on the settlement of the offshore loans made by the private companies. In a similar move, the government set up INDRA (the Indonesian Restructuring Assets) aimed to hedge the debts of the Indonesian debtors against fluctuating conversion rates. Next, on 9 September 1998, the government formed the Jakarta Initiative to provide access to the companies to obtain new capital and generate their businesses. The step was taken as part of the restructuring program and banking recapitulation.

2. Focus Of Policies 1997-1999

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The world market globalization further triggered more impacts to the liberalization of international market. This condition made it difficult to control the monetary sector from the world economic pressure. Under such condition, the pricing process (currency exchange rate, interest rate, share index, commodity price, etc) would be jointly determined by the other countries' economies. The monetary crises that inflicted a number of countries in South America, Eastern Europe and Asia including Indonesia could not be separated from the said market globalization process.

As the rupiah exchange rate was plummeting against foreign currencies, especially US Dollar since mid 1977, it eroded the public confidence in rupiah, and later to the banking institution, and furthermore in the Government's handling of the crisis. The monetary policies made throughout this period were focused on curbing foreign currency speculative deals and simultaneously secure the country's foreign exchange reserves.

3. Strategic Steps 1997-1999

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Rupiah was sliding further and at one point reached a record low of 600% within less than one year, namely from Rp 2,350 to Rp 16,000 against US dollar. Incredibly, the inter-bank interest rate at one point jumped to 60% p.a. As one of its direct implications, the distribution of goods was temporarily halted while awaiting price stability and improved security following street rallies and destruction of trade centers by the rioters in several cities. Until the end of this period, Indonesia's economic growth dropped 13.7%, prices of goods soared, many companies went bankrupt, unemployment rate rose and numerous public facilities and trade centers were heavily damaged.

4. Foreign Exchange Policies in Indonesia 1997-1999

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This act stipulated that all citizens were free to own and use foreign exchange, but they had to give its reason and provide the data of the traffic of foreign exchange they did.

In correspond to such regulation, Bank Indonesia obligated the banks to apply the prudential banking when dealing in foreign exchange and managing it. Meanwhile, the government had not regulated how to notify the owning and using of foreign exchange by the general public.

A number of policies made during the previous periods, particularly in respect to Foreign Capital Investment and offshore loans, had increased the foreign exchange reserves amount in early 1997. Moreover foreign investors were more tempted to invest their capital in Indonesia.

Unfortunately, the plummeting rupiah conversion rate against foreign currencies, especially the US dollar from 1997, had triggered immense purchase of foreign currencies by the private sector. As a result, Indonesia's foreign exchange reserves nearly experienced a deficit, amid enormous amount of offshore borrowings. The situation further deteriorated due to the sharp rupiah depreciation which paralyzed the country's foreign exchange buying power. Consequently, the letters of credit (L/Cs) issued by Indonesian banks were not honored overseas. The condition further aggravated due to the short supply of imported goods such as medicine and baby foods. To cope with this, Bank Indonesia was forced to give a cash guarantee to such L/Cs.

Nonetheless, the offshore loans must be selective, namely meeting the following criteria:

- 1) no political attachment,
- 2) prioritizing on loans with soft prerequisites,
- 3) their use conformed to the development plans, and
- 4) adjusted to their repayment ability

5. Exchange Rate Policies in Indonesia 1997-1999

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To salvage its foreign exchange reserves, on 14 August 1997, the intervention band was lifted and Indonesia began to introduce the floating exchange rate until now. This system was formalized through Act No. 23 and 24 of 1999. Under this act, the exchange rate system in Indonesia is determined by the Government upon receiving a recommendation from BI. This measure was taken because the foreign exchange system would result in far reaching impacts, not only to the monetary and financial sectors but also to the real economic activities.

6. Foreign Debt Policies 1997-1999

The weakening of the rupiah exchange rate which lingered on put an increasing pressure to Indonesia's settlement of offshore loans. This was a result of several factors, namely: most of the private sector's borrowings were not hedged, the short-term borrowings were used to fund long-term business ventures, and offshore loans were used to fund business ventures with domestic orientation.

The weakening of the rupiah exchange rate which lingered on put an increasing pressure to Indonesia's settlement of offshore loans. This was a result of several factors, namely: most of the private sector's borrowings were not hedged, the short-term borrowings were used to fund long-term business ventures, and offshore loans were used to fund business ventures with domestic orientation. Worse, the weakening rupiah exchange rate eroded the creditor's confidence against the debtor's capability to settle their debts. As a consequence, the private sector was facing a problem obtaining a rollover for their debts that matured, and this triggered a crisis of private sector's borrowings.

The policy adopted to settle the borrowings made by the private sector was as follows: The PKLN team backed up by the Government was involved in a series of negotiation with the foreign creditors represented by the Bank Steering Committee. The negotiations were held in Frankfurt on 4 June 1998 and reached an agreement on settling the interbank borrowings, private sector's loans and trade financing. The settlement of interbank borrowings took place through the exchange offer. First, the exchanged borrowings were the ones due until 31 March 1999. They were rescheduled as new borrowings with the maximum tenure of 4 years. The total amount of national banks' borrowings that the team managed to exchange reached USD3 billion involving 41 participant banks. From such amount, 13% was rescheduled for another year, 26,6% for another two years, 48% for another 3 years, and 12.1% for another four years.

In correspond to the settlement of the private sector's short-term offshore loans, the Government set up INDRA which served as an intermediary body between the debtors comprising Indonesian companies, and foreign creditors. In its further development, INDRA further worked out such loan schemes. With respect to the INDRA's programs, the Government appointed the Jakarta Initiative Task Force to become the facilitator for the companies facing a problem in settling their borrowings. As a result, the debtors could choose to follow INDRA's program or alternative methods, such debt-to-equity swap and out-of-court settlements. This task force, from its establishment until the end of 1998, managed to tackle 122 cases involving borrowings worth USD 15.5 billion.

As regards the government's offshore loans, the government signed a Paris Club MOU on 23 September 1998 with the creditors who represented 17 donor countries. This agreement marked the rescheduling of the obligation to repay the principle loans which matured during the consolidation period, namely as from early August 1998 to the end of March 2000. Based upon such Paris Club MOU, the loans to be restructured amounted to USD4.2 billion and were made up of soft loans worth USD

1.2 billion and export credit facilities worth USD3 billion. The soft loans were rescheduled or financed by the new loans with the tenure of 20 years, including 5-year grace period at the interest rate prevailing for soft loans. The export credit facilities were refinanced or rescheduled for 11 years, including 3-year grace period at the interest rate prevailing in the market..